

Private Letter Ruling: Nonresident partners with no Illinois sourced income other than from partnerships may join in composite returns filed by those partnerships without the need for filing a petition as long as all Illinois sourced income is reported and taxed on the composite returns.

February 28, 2001

Dear Ms. Brown:

This is in response to your letter dated January 19, 2001 in which you request a Private Letter Ruling on behalf of the listed partnerships. The Private Letter Ruling will bind the Department only with respect to the listed partnerships for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither the listed partnerships nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented are as follows:

We are writing to you on behalf of each of the above-referenced partnerships ("the partnerships"), in order to request permission to file composite tax returns in your state for the 2000 and subsequent tax years for each of the partnerships. For the reasons stated in this letter, we believe that each of the partnerships meets all of the qualifications for filing a composite return in your state. Please note that in previous years your state has granted the partnerships permission to file separate composite returns.

Each partner electing to be included in a composite return:

- ⇒ is a limited partner and an inactive participant in one or more of the partnerships,
- ⇒ is an individual or an individual who has invested in the partnerships through a S Corporation owned solely by this individual,
- ⇒ is a full-year nonresident of your state,
- ⇒ will have no additional source income from your state,
- ⇒ will not file an individual return in your state,
- ⇒ agrees to sign a statement affirming their eligibility and their election to be included in the composite tax return,
- ⇒ agrees to waive the right to claim individual deductions, exemptions and credits that would otherwise be available, and
- ⇒ agrees to have the tax on sourced income calculated at your state's highest marginal tax rate.

During the previous tax year, due to certain federal restrictions, several of the partners in the partnerships were required to contribute their ownership in the partnerships into S corporations solely owned by the contributing partner. The S corporations' only activities are as limited partners in one or more partnerships. Although, your state has previously not allowed the owners of these S corporations to participate in these composite returns, we respectfully request permission to include them in the composite returns for this and future tax years.

It is also important to note that the partnerships are not doing business in your state. Their sole source of income derived from your state is their distributive share of income from their investment in underlying partnerships. Due to the partnerships' lack of control over what the

underlying partnerships invest in, the partnerships may or may not have income sourced to your state in a given tax year. Therefore, although we are requesting permission to file composite tax returns in your state, the partnerships will ultimately only file composite tax returns in a given tax year to the extent that they have source income from your state during that tax year.

The purpose of allowing composite tax returns is to ease the administrative burden on your state of having to process a large number of individual tax returns, as well as to ease the compliance efforts of the taxpayer filing the returns. Since we anticipate that a significant number of partners will elect to be included in the composite tax returns, the number of individual returns that will have to be filed with and processed by your state will diminish considerably. Although your state has previously not allowed owners of the S Corporations to participate in the composite filings, these individuals have been included in composite returns filed on other states with great success. Since a significant number of the S Corporation's owners participated in the composite filings in other states, allowing the owners of the above-mentioned S corporations to participate in the composite filing in your state will further reduce the number of returns that require processing by your state. We therefore believe that your approval of this request will be beneficial to both your state and the partnerships.

Attached is a schedule detailing the name, federal employer identification number and the number of partners in each partnership. Also attached is an executed power of attorney form for each of the partnerships authorizing us to represent them in this matter.

If your state approves this request, please sign in the space provided below and return this letter to our office in the enclosed self addressed envelop. If your state denies the request to include the owners of the S corporations, we respectfully request permission to file the composite returns excluding those individuals. If your state chooses to deny the request for filing composite returns, please contact us so that we can discuss this decision with you prior to receiving a written response.

RULING

The general rule under section 502(a) of the Illinois Income Tax Act ("the IITA"; 35 ILCS 5/101 *et seq.*) is that every person liable for Illinois income tax must file an income tax return. Section 502(f) of the IITA creates an exception to this general rule in the case of certain taxpayers who are partners or S corporation shareholders. The section provides:

The Department may promulgate regulations to permit nonresident individual partners of the same partnership, nonresident Subchapter S corporation shareholders of the same Subchapter S corporation, and nonresident individuals transacting an insurance business in Illinois under a Lloyds plan of operation, and nonresident individual members of the same limited liability company that is treated as a partnership under Section 1501(a)(16) of [the IITA], to file composite individual income tax returns reflecting the composite income of such individuals allocable to Illinois and to make composite individual income tax payments.

Under the authority of IITA section 502(f), Illinois Income Tax Regulations section 100.5100 sets out the requirements for a taxpayer to be eligible to be included in a composite return. Section 100.5100(a) states:

In general. A composite return may be filed on behalf of nonresident individuals, trusts, and estates who derive income from Illinois and who are partners, or S corporation shareholders, or who transact insurance business under a Lloyds plan of operation. The respective partnership, S corporation or insurance business shall file such composite return and shall make composite income tax payments.

Section 100.5100(b) states:

Eligibility. The right to be included in a composite return is limited to nonresident and resident individuals, trusts, and estates who are partners of the same partnership, shareholders of the same S corporation, or individuals transacting an insurance business in Illinois under a Lloyd's plan of operation. The eligibility of resident individuals, trusts, and estates is conditioned upon compliance with subsection (c) of this Regulation.

Example: The Acme partnership consists of a general partner and fifty(50) limited partners. The general partner is a regular corporation, and the limited partners consist of twenty-six (26) nonresident individuals, twenty (20) resident individuals, an S Corporation, a partnership, a nonresident trust, and a estate. The twenty-six (26) nonresident individuals, the nonresident trust, and the nonresident estate are automatically eligible to be included in a composite return. The twenty (20) resident individuals may be included in the composite return with the nonresidents if the Department grants their petition. None of the other entities may be included in the composite return.

Applying the provisions of the IITA and Regulations discussed above to the facts here, each of the partnerships you have listed may file a composite return that includes the Illinois source items of each of the *individual* nonresident partners of the respective partnerships. Under regulations section 100.5100(b) the individual nonresident partners are automatically eligible to be included in the composite return. However, neither the S corporation partners nor the sole individual shareholders of such S corporation partners may be included in such composite returns. Regulations section 100.5100(a) specifically limits the right to be included in a composite return to *individual* partners (or a trust or estate). The S corporation partners are not individuals, and the sole shareholders of such corporations are not partners. Accordingly, they may not be included in the composite returns filed by the listed partnerships.

This ruling applies to the 2000 taxable year and all future years during which the pertinent statutory law, case law, and rules and material facts discussed above remain unchanged. The facts upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts in this ruling.

Sincerely,

Brian L. Stocker
Staff Attorney (Income Tax)